STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **BENJAMIN SON AND LILIA SON** for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1998 and 1999.	:	SMALL CLAIMS DETERMINATION DTA NO. 819365

Petitioners, Benjamin Son and Lilia Son, 25 Hill Crescent Road, Port Jefferson, New York 11777-1258, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1998 and 1999.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, State Office Building, Veterans Memorial Highway, Hauppauge, New York on August 26, 2004 at 1:15 P.M. Petitioners appeared by Binder & Binder, P.C. (Harry J. Binder, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Nazmul Quayyum and Jon Obert).

The final brief[1] in this matter was due by December 24, 2004 and it is this date that commences the three-month period for the issuance of this determination.

ISSUES

I. Whether certain deductions claimed by petitioner Lilia V. Son on Federal Schedule C for the years 1998 and 1999 are properly considered as deductible ordinary and necessary

[1] Petitioners' reply brief was not received until January 2, 2005 and therefore it was not considered in the rendering of this determination.

expenses connected with the conduct of a business operated with a profit motive or are nondeductible personal expenses.

II. Whether, if there is a deficiency in tax for 1998 or 1999, petitioners have established that the deficiency was not due to negligence or intentional disregard of the Tax Law, rules or regulations, thus permitting the negligence penalty to be waived or abated.

FINDINGS OF FACT

1. Petitioners[2] herein, Drs. Benjamin T. Son and Lilia V. Son, filed timely New York State resident income tax returns for the years 1998 and 1999. On the 1998 return petitioner claimed a business loss of $80,000.00, while the 1999 return claimed a business loss totaling $15,800.00.

2. The business losses claimed on petitioner's 1998 and 1999 New York returns were also claimed on her 1998 and 1999 Federal income tax returns and reported on Federal Schedule C, Profit or Loss from Business. Federal Schedule C for both years reported that Dr. Lilia V. Son's principal business or profession was a diagnostic medical testing facility known as Doppler Ultrasound Diagnostic Services located at 4242 Folden Street, Flushing, NY 11357. The following table contains a summary of the amounts reported on Schedule C for 1998 and 1999:

ITEM	**1998**	**1999**
Gross income	$ -0-	$ -0-
Legal fees	10,000.00	7,500.00
Equipment lease expense	70,000.00	-0-
Supplies	-0-	8,300.00

[2] Petitioner Dr. Benjamin T. Son is involved in this proceeding solely as the result of having filed joint income tax returns with his spouse. Accordingly, unless otherwise noted, all references to petitioner shall pertain to Dr. Lilia V. Son.

Net loss	$80,000.00	$15,800.00

3. Following an audit, the Division of Taxation ("Division") issued a Notice of Deficiency to petitioner and her spouse dated March 25, 2002 asserting that $6,581.36 of additional New York State personal income tax was due for the years 1998 and 1999. The Notice of Deficiency also asserted that interest and a negligence penalty was due for each year at issue. The Division's determination that additional tax was due for 1998 was premised on its complete disallowance of the $80,000.00 business loss claimed on Federal Schedule C and also the disallowance of $2,400.00 of miscellaneous itemized deductions for unreimbursed employee business expenses. For the 1999 tax year, the Division disallowed $8,300.00 of the claimed $15,800.00 Federal Schedule C business loss, $2,400.00 of unreimbursed employee business expenses and $6,545.00 of other miscellaneous itemized deductions.

4. At the small claims hearing held herein, the Division withdrew the adjustments it made for the disallowance of $2,400.00 in unreimbursed employee business expenses for both 1998 and 1999 and also the disallowance of $6,545.00 of other miscellaneous itemized deductions for 1999. Accordingly, the only issues left in dispute are the total disallowance of the $80,000.00 business loss for 1998; the partial disallowance of $8,300.00 of the claimed $15,800.00 business loss for 1999 and the assertion of a negligence penalty.

5. From at least 1994 through the date of this small claims hearing, petitioner has been employed on a full-time basis by the State of New York at its Pilgrim State Hospital located in West Brentwood, Suffolk County, New York. Some time prior to June 1, 1994, Dr. Son became acquainted with one Belen A. Sering. Although Ms. Sering was licensed to practice medicine in the Philippines, she did not possess a license to practice medicine in the State of New York.

6. In 1994, petitioner and Ms. Sering entered into two separate agreements for the lease of medical equipment. It appears that petitioner and Ms. Sering initially intended to conduct business in corporate form as Doppler Ultrasound Diagnostic Services, Inc., and some preliminary actions were taken to establish such a corporation. However, when it became known that Ms. Sering was not licensed to practice medicine in New York, thus preventing her from becoming a shareholder in a professional service corporation, no further action was taken to incorporate Doppler Ultrasound Diagnostic Services, Inc. It appears that petitioner and Ms. Sering thereafter operated as either a de facto partnership or joint venture, although they continued to use the name Doppler Ultrasound Diagnostic Services, Inc.

7. The record contains a general letter of introduction on Doppler Ultrasound Diagnostic Services, Inc., letterhead addressed to "Dear Doctor," wherein area doctors were advised of the opening of Doppler Ultrasound Diagnostic Services, Inc.'s vascular laboratory. This letter seeks patient referrals from area doctors for diagnostic services and was signed by Belen A. Sering, M.D., President, and Lilia V. Son, M.D., Vice President.

8. On June 1, 1994, petitioner and Ms. Sering entered into the first of two lease agreements with Copelco Leasing Corporation (hereinafter "Copelco"). The June 1, 1994 agreement was for the lease of a colored imaging Doppler scan and related equipment for use in a vascular laboratory providing Doppler diagnostic services. The full legal name of the lessee as shown on the lease was "Lilia V. Son, M.D. and Belen Sering, M.D. jointly and severally." The lease was for a term of 63 months, payable in 60 installments of $1,644.00 per month starting September 1, 1994. Ms. Sering made the required monthly payments on this first lease from

September 1994 through February 1995 and neither petitioner nor Ms. Sering made any payments thereafter.

9. On September 6, 1994, petitioner and Ms. Sering entered into the second lease agreement with Copelco for the lease of medical equipment described as "Mortara Eli/100 Interpretive EKG and Puritan Bennett Spirometer." This lease was also in the name of Lilia V. Son, M.D., and Belen Sering, M.D., jointly and severally, and required monthly payments of $205.35 for a period of 36 months. Ms. Sering made the first three monthly payments and neither petitioner nor Ms. Sering made any payments thereafter.

10. Copelco commenced an action against petitioner and Belen A. Sering to recover the payments it was due pursuant to the two equipment leases dated June 1, 1994 and September 6, 1994. On April 23, 1998, a judgement was entered in favor of Copelco "against defendants Lilia V. Son and Belen A. Sering in the sum of $133,754.31. . . ."

11. On June 18, 1998, petitioner and Copelco entered into a Stipulation of Settlement wherein petitioner agreed to pay Copelco the sum of $70,000.00 and withdraw all notices of appeal. Coplelco agreed to provide petitioner with a release and also file with the court a satisfaction of the judgement with respect to Lilia V. Son only.

12. It is undisputed that in 1998 petitioner borrowed $51,000.00 from the New York State and Local Retirement System and together with $19,000.00 of personal funds she paid the $70,000.00 due Copelco pursuant to the Stipulation of Settlement dated June 18, 1998. Petitioner, in 1998, also paid her attorney $10,000.00 in legal fees to represent her in the Copleco action. These two amounts form the basis for the expenses claimed by petitioner on her Federal Schedule C for the 1998 tax year.

13. On some unknown date prior to October 12, 1995, it appears that Doppler Ultrasound Diagnostic Services, Inc., Belen A. Sering and petitioner entered into a lease with Chrysler Credit Corporation (hereinafter "Chrysler") for the lease of a motor vehicle. The lease agreement was not submitted in evidence at this proceeding so the actual lessee is not known nor is the duration and cost of the lease disclosed. The record herein contains a letter dated October 30, 1995 addressed to petitioner from a collection agent stating that Chrysler had a claim against petitioner for the sum of $7,949.15 plus interest from October 12, 1995. This same collection agent issued a letter to petitioner dated May 8, 1997 captioned "Chrysler Credit Corporation vs. Doppler Ultrasound Diagnostic Services, Inc., Belen A. Sering and Lilia V. Son" which states that "[T]his letter will confirm that your debt to the creditor has been paid in full upon clearance of your payment money orders. We will take no further action."

14. Although petitioner's Federal Schedule C for 1999 reported a deduction of $8,300.00 for supplies, she readily admits that the $8,300.00 figure was entered on the wrong line of Federal Schedule C. The $8,300.00 deduction at issue for 1999 actually represents petitioner's claimed basis in the motor vehicle leased from Chrysler which petitioner considered to be a business asset rendered useless during the 1999 tax year.

15. The record herein does not disclose if, or to what extent, Doppler Ultrasound Diagnostic Services, Inc. or Belen A. Sering and Lilia V. Son conducted the intended diagnostic services business before it ceased operations. There seems to be no dispute that Ms. Sering was not able to obtain a license to practice medicine in New York and that she eventually returned to the Phillippines without making any further payments on the two equipment leases or the motor vehicle lease with Chrysler.

SUMMARY OF THE PARTIES' POSITIONS

16. Petitioner maintains that she has adduced sufficient evidence to establish that in 1994 she clearly entered into the medical diagnostic services business with a profit motive and that the $70,000.00 in lease payments and $10,000.00 in legal fees paid in 1998 are ordinary and necessary business expenses deductible in the year paid.

17. With respect to the motor vehicle leased from Chrysler, petitioner asserts that as a personal guarantor of the lease she was forced to pay the unpaid lease amounts and the final purchase option. When paid, petitioner argues that this automobile became an asset subject to depreciation. It is petitioner's position that the automobile was leased by the business and was used exclusively by Ms. Sering in the medical diagnostic services business. Petitioner contends that she ultimately gained control of the vehicle in 1999 and that at the time she gained control the car was totaled out and rendered useless. The $8,300.00 deduction purportedly represents petitioner's basis in the vehicle at the time it was determined to be valueless.

18. The Division argues that petitioner has failed to establish that she intended to start a business as a sole proprietor, partnership or corporation and that she merely co-signed the three lease agreements in question with Ms. Sering as a friend to help her start a business. The Division asserts that petitioner's activities with respect to the three leases in question lacked the requisite profit motive, thus making her subsequent payments nondeductible personal expenses.

CONCLUSIONS OF LAW

A. Internal Revenue Code § 62 requires that a taxpayer include in adjusted gross income all income derived from a business less all trade and business deductions attributable to the carrying on of such business. Internal Revenue Code § 162 provides that a deduction is allowed for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying

on any trade or business. . . ." Pursuant to Internal Revenue Code § 162(a)(3) lease payments made by a taxpayer "as a condition to the continued use or possession, for purposes of the trade or business, of property . . . " are specifically classified as allowable deductions.

B. While it is undisputed that lease payments made for property used in a trade or business are allowable business deductions, the controversy in the instant matter concerns whether petitioner has met her burden of proof (Tax Law § 689[e]) to show that her signature on the leases, association with Belen A. Sering and other activities with respect to the operation or planned operation of a diagnostic vascular laboratory can be properly considered as a trade or business entered into with a profit motive.

C. Considering all of the evidence, including petitioner's credible testimony, I conclude that petitioner has sustained her burden of proof to show that her activities with respect to the diagnostic vascular laboratory qualified as the conduct of a trade or business which she entered into with a bona fide profit motive. Accordingly, the $70,000.00 lease payment made on the medical equipment in 1998 is deemed to be an allowable business deduction. Furthermore, since the $10,000.00 legal fee paid by petitioner in 1998 was the result of a business transaction, it too qualifies as an allowable business deduction.[3]

D. I reach a different conclusion with respect to petitioner's claimed $8,300.00 deduction in 1999 for her basis in the leased automobile which was alleged to be worthless in said year. Initially, it must be noted that the leased automobile, unlike the leased medical equipment, could have been used for personal versus business reasons. Petitioner's testimony that Ms. Sering used the leased vehicle solely for business purposes is insufficient to support that the vehicle was used

[3] Assuming, arguendo, that petitioner's activities with respect to the diagnostic vascular laboratory did not rise to the level of carrying on a trade or business, the $80,000.00 paid in 1998 would, in my view, be properly classified as expenses incurred in the production of income and therefore deductible as miscellaneous itemized deductions pursuant to Internal Revenue Code § 212.

exclusively for business purposes when one considers that the diagnostic vascular laboratory business apparently failed soon after its inception, perhaps in late 1994 or early 1995, thus bringing into question how the vehicle could have been used exclusively in this business after the date it ceased business operations. It is doubtful that the leased vehicle was used exclusively for business when the business ceased operations in 1994 or 1995, yet petitioner did not, for unstated reasons, gain control of the vehicle until some four years later in 1999.

Also, the record does not contain any evidence to support that petitioner's basis in the vehicle was $8,300.00 in 1999, and there is no credible evidence to show that the vehicle was in fact worthless in 1999. Finally, the letter dated May 8, 1997 from the collection agent handling this matter for Chrysler indicates that petitioner's debt to Chrysler had been paid in full. As a cash basis taxpayer it would seem that petitioner may have been entitled to a business deduction in 1997, and not 1999, for the portion of the lease payment that applied to the business use, if any, of the vehicle. For all of these reasons, the $8,300.00 deduction claimed on Federal Schedule C for 1999 was properly disallowed by the Division.

E. Turning next to the imposition of the negligence penalty, petitioner has failed to sustain her burden of proof to show that the deficiency was not due to negligence or intentional disregard of the Tax Law or rules and regulations. Accordingly, the negligence penalty is sustained.

F. The petition of Benjamin and Lilia Son is granted to the extent that the deficiency for the 1998 tax year is canceled in full; the deficiency for the 1999 tax year is to be recalculated based on the disallowance of the $8,300.00 expense claimed on Federal Schedule C; the Division

is hereby direct to recompute the deficiency consistent with this determination and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York
March 17, 2005

/s/ James Hoefer
PRESIDING OFFICER